

Outsourcing Vendor Managers: Negotiate the Contract to Successfully Manage the Deal

Helen Huntley

This information will help outsourcing vendor managers understand how key aspects of the master service agreement (MSA) can drive anticipated service provider behavior and expected deal outcomes. Understanding the service provider's obligations is essential to the successful management of the deal.

Key Findings

- Clients often view outsourcing contracts in a single dimension: the statement of work (SOW), which defines how services will be performed.
- The MSA is also of critical importance because it details the processes, management, escalation and rules between the two parties.
- The MSA not only contains the legal components (terms and conditions) but also defines the outsourcing arrangement and explains — through 19 articles — how the parties will work together.
- The MSA, service levels, scope of work, pricing and other contract schedules (also called attachments or appendixes) are all important components of an outsourcing contract and will be used to manage the deal.

Recommendations

Client vendor managers should:

- Play an active role in developing and negotiating the MSA from the outset, because it will be instrumental in setting the deal's management structure.
- Not assume that legal counsel alone needs to work on the MSA.
- Be comprehensive and consider as many scenarios as possible when creating the MSA to mitigate potential pitfalls later.

TABLE OF CONTENTS

Analysis	3
1.0 The Role of the MSA	3
1.1 Guiding Principles: Explain Plans to Work Together and Deal Intent	5
1.2 Services: Document Services to Be Provided and Commitments	6
1.3 Personnel: Specify Personnel Terms and Conditions.....	7
1.4 Record-Keeping and Audit Rights: Define Client Requirements.....	8
1.5 Term and Termination (Exit Clauses): Articulate Rights and Obligations	9
1.6 Disentanglement: Define End-of-Deal Expectations	9
1.7 Dispute Resolution: Define the Process and Escalation Path	10
1.8 Subcontractors: Set Clear Expectations for Their Use.....	10
1.9 Conclusion: A Comprehensive MSA Achieves Results	11
Recommended Reading.....	11

LIST OF FIGURES

Figure 1. The 19 Articles With the Eight MSA Management Articles Covered in This Research	5
---	---

ANALYSIS

1.0 The Role of the MSA

The outsourcing contract MSA serves as the overarching terms and conditions (T&Cs) of the deal and subsequent schedules (also referred to as "attachments" and "appendixes" — see Note 1) that define the services to be performed. A best-practice MSA should contain 19 distinct articles that manage the relationship and define the outsourcing arrangement between the service recipient and its service provider.

Internal or external legal staff drafts most outsourcing MSAs. While the MSA serves as the legal agreement between the two parties, it also manages the relationship and how the parties plan to work together through the course of the contract term, which is why individuals involved in vendor management must be involved in creating and negotiating the contract. Being involved in the negotiations for the deal and understanding the obligations that have been created are absolutely critical to managing the deal after the contract has been signed.

If contract building and negotiations are left solely to legal staff, vendor managers miss a critical opportunity to truly understand the deal and the obligations, for both involved parties. Additionally, being involved also creates a chain of historical understanding about what language was put into the contract, and why.

Many outsourcing contract MSAs are not comprehensive enough, because enterprise and vendor managers often consider the MSA to be nothing more than a legal document for lawyers to craft. The vendor managers may focus solely on the contract schedules, such as the service levels, scope of work (SOW) and pricing. This is misguided, because the processes, escalation path and rules managing the deal are part of the MSA and are essential to establishing and maintaining a successful relationship between the service provider and client.

If issues arise, a well-thought-out MSA can provide fundamental and clear rules on how to resolve problems quickly and effectively for the benefit of both parties. In short, the MSA will help you manage the deal and cannot be left up to lawyers alone to create, negotiate and finalize. If vendor managers focus solely on the attachments to the MSA, such as the SOW, they will not truly understand the uppermost T&Cs binding the two parties together in the contract.

A typical MSA contains 19 distinct articles:

- Article 1: Guiding Principles
- Article 2: Services
- Article 3: Personnel
- Article 4: Assets and Third-Party Contracts
- Article 5: Retained Authorities
- Article 6: Fees
- Article 7: Record-Keeping and Audit Rights
- Article 8: Representations, Warranties and Covenants
- Article 9: Term and Termination (Exit Clauses)

- Article 10: Disentanglement
- Article 11: Limitations of Liability
- Article 12: Proprietary Rights
- Article 13: Security and Confidentiality
- Article 14: Legal Compliance
- Article 15: Indemnification
- Article 16: Insurance
- Article 17: Dispute Resolution
- Article 18: Use of Subcontractors
- Article 19: Miscellaneous

This research focuses on helping vendor managers understand the importance of being involved in creating and negotiating the MSA. Therefore, this research will focus on eight of the 19 MSA articles. These eight articles relate specifically to outsourcing deal management. Figure 1 shows the 19 articles with the eight MSA articles covered in this research highlighted in red. The eight articles include:

- Guiding Principles
- Services
- Personnel
- Record-Keeping and Audit Rights
- Term and Termination
- Disentanglement
- Dispute Resolution
- Use of Subcontractors

Figure 1. The 19 Articles With the Eight MSA Management Articles Covered in This Research

Master Service Agreement				
Guiding Principles	Services	Personnel	Assets and Third-Party Contracts	Retained Authorities
Fees and Payment Terms	Record-Keeping Audit Rights	Represent. Warranties Coverage	Term and Termination	Disentangle-ment
Limitations of Liability	Proprietary Rights	Security and Confidentiality	Legal Compliance	Indemnifi-cation
Insurance	Dispute Resolution	Use of Sub-contractors	Miscellaneous	

Source: Gartner (March 2009)

1.1 Guiding Principles: Explain Plans to Work Together and Deal Intent

Management Driver: How will we work together, and why are we in this deal?

The outsourcing MSA should document the guiding principles at the beginning of the agreement. This is accomplished in MSA Article 1. Best practice dictates that both parties develop the guiding principles for the agreement, because these will be used to manage the deal and relationship between the two parties.

The MSA guiding principles should stipulate how the two parties will manage the relationship. The contract typically calls for each party to designate an individual as the primary point of contact for all matters pertaining to the agreement throughout the term. If vendor managers plan to use other forms of governance, such as outsourcing committees or sourcing management office, the roles, responsibilities and level of authority for the relevant bodies must be defined in the contract. This enables both parties to understand the governance mechanisms upfront.

The guiding principles for the agreement should also describe the parties' overall objectives for the agreement (that is, the deal intent), which defines the rationale used to enter the outsourcing agreement. Vendor managers can refer to it at any time, if they become unclear about why their enterprise entered the deal and the intended value expectations. This understanding aids in managing the deal as expectations are discussed and documented upfront.

Deal intentions for the enterprise may include:

- Enhancing IT capabilities and effectiveness
- Reducing IT costs

- Improving and maintaining technology
- Focusing on core competencies
- Improving business processes
- Creating new business processes
- Realizing or improving distinctive business outcomes
- Creating new products

Deal intentions for the service provider may include:

- Expanding into a new geographical area
- Using a new technology or service offering

1.2 Services: Document Services to Be Provided and Commitments

Management Driver: What is in this deal, and what commitments have been made?

The MSA focusing on services provides high-level statements of the services that the service provider will deliver. These services are usually termed service towers, and include data center services, desktop managed service or help desk services. The SOW, service level and price schedules, which are attached to the MSA, contain detailed descriptions of the work that will be performed to deliver the services.

In the MSA services article, the provider makes extensive commitments to comply with service levels, and the policies and procedures they will follow when a delivery issue occurs. It is critical to understand these commitments when managing the deal. For example, outsourcing vendor managers need to know what commitments the provider made in the MSA to resolve problems. This commitment would answer the following questions:

- Did the service provider commit to a root cause analysis?
- To what level of failure is the service provider committed?
- How quickly did the service provider say it would notify the enterprise if problems develop?

This MSA article should also identify the high-level guidelines for the following. Note that separate attachments or schedules to the contract will contain the detail for some of the areas:

- **Benchmarking:** Establishes the service recipient rights, guidelines and actions following the benchmarking analysis.
- **Transition services:** Establishes the guidelines for the transition plan, progress reporting for the transition and the timeline for provider assumption of financial responsibility for the provision of services.
- **Purchasing agent services:** Establishes mechanisms for the service provider to procure service recipient approved product list hardware and software, if requested to do so.
- **Standards and procedures:** Establishes the service provider's responsibility to create a standards and procedures manual, as well as to update and store the standards and procedures manual.

- **Service compatibility:** Establishes service provider compatibility to the service recipient's existing environment and the rules for introducing incompatible systems, if the situation arises.
- **Change management:** Provides the minimum standards and procedures for in-scope and out-of-scope services.
- **Reporting requirements:** Establishes the minimum types of reports that the service provider is obligated to provide the service recipient at predetermined intervals. Typical reports include invoices, audit reports, end-user satisfaction and unauthorized system access reports.
- **Critical milestones:** Grants the service recipient the right to withhold payments, until an agreed-on milestone has been achieved or until fees delineated in the pricing schedule that is attached to the MSA have been reduced. Service recipients will have this right if the parties have agreed to designate certain milestones, activities, actions or projects under the agreement as critical milestones and if the service provider fails to meet the critical milestones on the established date.
- **Cooperation:** Establishes service provider cooperation with the service recipient and all third parties that the service recipient designated as reasonably required or necessary to perform the services.

1.3 Personnel: Specify Personnel Terms and Conditions

Management Driver: What personnel will do the work; do they have the right skills; and how will they be treated?

The MSA personnel article documents the T&Cs for personnel in the contract, including:

- Key personnel
- Affected and selected employees
- Minimum proficiency levels
- Training, supervision, conduct and management
- Solicitation of personnel

Key personnel: The key personnel T&Cs designate selected positions (typically, management or operations) as key personnel within the contract. Individuals involved in contract negotiations on the client side should designate key personnel positions, based on the knowledge required to fill the position, significant interface to customers or management of critical delivery elements. This T&C typically allows the client the right to interview and reject service provider employees suggested to fill a key role. This right extends from initial hire to removal or replacement of a key position. Specific provisions in the agreement bind key personnel to the account and prevent the service provider from rotating them out of key positions for a period of time (generally 12 to 18 months). This T&C gives clients more rights to select candidates for key positions from the start, which ensures that service providers choose the most suitable candidate for the right key position in the deal.

Affected and selected employees: The affected and selected position T&Cs define the process and procedures to handle client human capital that the outsourcing agreement will affect. A schedule attached to the MSA will also contain detailed plans for human capital management.

Minimum proficiency levels: The minimum proficiency level T&C requires all service provider personnel, including subcontractors, to have the experience, training and expertise sufficient to perform the service provider's obligations under the agreement. The MSA should stipulate the minimum qualifications or level of expertise of service provider staff, so that service providers cannot utilize underqualified staff or subcontractors for delivery.

Training, supervision, conduct and management: The training, supervision, conduct and management T&C identifies all service provider resources, including its subcontractors, as service provider employees and not client employees. As such, the service provider is responsible for training, supervising, paying all wages, including overtime pay and other premium pay, and managing its employees and their conduct.

Solicitation of personnel: The solicitation of personnel T&Cs establishes either a no-solicitation policy or guidelines on the solicitation of personnel. Guidelines usually state that, during the term of the agreement, and for a period of time after the agreement ends (usually 12 months), neither party shall, without prior consent of the other party, directly or indirectly solicit for employment any employee of the other who is involved in performing the agreement.

1.4 Record-Keeping and Audit Rights: Define Client Requirements

Management Driver: How do I ensure that my service provider is in compliance with record-keeping obligations, and what are my audit rights?

The record-keeping and audit rights article requires the service provider to maintain complete and accurate records with respect to the agreement, using acceptable accounting rules, such as generally accepted accounting principles. To ensure this compliance, the outsourcing client must establish the right to perform a variety of audits on the service provider. Clients must contractually stipulate not only the right to conduct an audit, but the type of audit they wish to perform, the desired time frames for the audit, how incurred costs will be allocated and the parties who may be involved in conducting the audit.

If an organization establishes these rights upfront in the MSA, the client will have appropriate access to conduct an audit and put auditable processes in place from the beginning of the relationship. This will help to ensure that both parties comply with the laws and regulations governing the client's business and industry. Failure to detail the required record-keeping and audit rights in the MSA could place an enterprise at risk of noncompliance, which could result in financial losses and damage to a business's reputation.

Types of audits that might be relevant to an organization's business and that outsourcing contract managers might want to stipulate in this MSA article include:

- **Operational audit:** Establishes the right of the service recipient, or its authorized representatives, to perform operational and security assessments with respect to the service provider's performance under the agreement.
- **Financial audit:** Establishes the right for the service recipient, or any independent third party selected by the service recipient, to fully audit the service provider's and/or its subcontractor's books and records to verify any amounts paid or payable. Financial audits typically provide full access to books, records, invoices or any material used to compute pricing.
- **Statement on Auditing Standards No. 70:** Refers to the American Institute of Certified Public Accountants' Statement on Auditing Standards, No. 70. This statement requires the service provider to conduct a Type II audit on its control objectives and control

activities, which often include controls over IT and related processes at a specific point in time, and includes detailed testing.

- **Sarbanes-Oxley compliance (this is pertinent to the U.S. only):** Within an outsourcing MSA, Sarbanes-Oxley (SOX) compliance is largely focused on the financial reporting controls that the service provider uses (restriction of access to systems, data and programs) when handling service provider information.

1.5 Term and Termination (Exit Clauses): Articulate Rights and Obligations

Management Driver: How will this deal end, and what are my rights if the deal is not working well?

At some point, the outsourcing deal will terminate for cause, for convenience, by default, because of change in control, or because the contract term has ended. Regardless of the reason, the current deal is guaranteed to terminate, either prematurely or on a predetermined schedule. Although the end may seem far away, both parties must agree to termination T&Cs and stipulate these in the MSA.

The following are generally contained in an outsourcing MSA:

- **Initial term:** Documents the effective term (start and end date) when the service provider is obligated to provide the services outlined in the agreement.
- **Renewal term:** Provides the client the ability to extend the initial term for fixed periods of time identified in the contract.
- **Early termination:** Documents the conditions for early termination of the contract (for convenience, change of control of the provider, and force majeure events).
- **Events of default and rights:** Documents the events that constitute default in the agreement (for example, the inability to achieve service levels after a defined period of time, failure to achieve critical milestones, breach of warranty and bankruptcy). It also documents the rights and remedies for default, if this occurs.

Outsourcing contract or relationship managers should consider what their enterprise will need when the contract ends to develop an appropriate exit strategy. The transition will be smoother if the MSA documents the processes and resources required to transfer the contract's operational and organizational components from the vendor to another party.

1.6 Disentanglement: Define End-of-Deal Expectations

Management Driver: What will happen when this deal ends, and how do we disengage?

Regardless of who terminates the deal, it is a best practice to document disentanglement obligations for both parties in the MSA. Disentanglement obligations typically cover:

- Knowledge transfer cooperation
- Transfer of assets
- Right-to-hire provisions and payment-for-disentanglement services

If outsourcing vendor managers have a clear understanding of how the organization plans to disengage from the deal, they can incorporate the right T&Cs into the MSA. For example, if an organization expects to have the right to hire service provider employees, who have been supporting its environment (for continuity of delivery), the contract must document the ability and process to offer employment, at the organization's discretion. Without addressing this issue in the

MSA, an organization will not be entitled to discuss with or offer employment to any service provider employees.

1.7 Dispute Resolution: Define the Process and Escalation Path

Management Driver: What happens when we have a delivery dispute?

The MSA article on dispute resolution documents the problem resolution process, including the escalation path, when a problem is found. This is critical for both parties, so each side must understand the process to follow in resolving problems. In many outsourcing contracts, the escalation path is as follows:

- Administrative-level review (by the client and service provider project executives)
- Executive-level review (by the client and service provider executives, who are normally the CIO or CIO equivalent for the client and the area manager for the service provider)
- Nonbinding mediation by independent mediator
- Arbitration or legal adjudication

If outsourcing contract managers do not give adequate attention to this MSA article, it will become more difficult to address delivery issues and to notify the right individuals in appropriate time frames. Clearly defining dispute resolution processes in the MSA enables both parties to understand the escalation path. This can facilitate faster problem resolution, keep delivery on track and minimize negative impact on service delivery.

1.8 Subcontractors: Set Clear Expectations for Their Use

Management Driver: How do I control the number of subcontractors that the service provider will be using?

Failure to define expectations for the use of subcontractors in the MSA means that the service provider could, at any time, start using or significantly increasing the number of subcontractors it uses to deliver the services in the MSA. If the provider significantly increases the proportion of subcontractors it uses, the client organization might feel that the service provider it contracted is no longer the provider performing the work, either to the same standard or in the way originally expected.

Using subcontractors may be perfectly acceptable, but can also cause challenges in productivity, communications with internal staff and delivery performance. The MSA article on subcontractors documents the approval or disapproval for the service provider to use subcontractors to perform the obligations within the agreement.

If subcontractors are allowed, the MSA should stipulate the percentage of personnel that can be subcontractors. In other words, the subcontractor article enables the service recipient to limit the number of subcontractors in the agreement, such as no more than 5% of delivery staff may be subcontractors. This article can also stipulate the client organization's right to interview and reject companies or subcontractor individuals to grant the client authority over the subcontractors used.

Service recipient staff involved in creating and negotiating the contract can define expectations for subcontracted labor by answering these questions in the MSA:

- Will subcontractors be allowed as resources in the deal?
- Do you want the right to accept or deny the use of subcontractors that were not identified as resources at the beginning of the deal?

- Do you want to interview and reject firms or individuals?
- Do you wish to limit the percentage of subcontracted labor in the deal?

Even if the service provider approves the use of subcontractors to perform services within the agreement, the client organization needs to be informed and the subcontractor must adhere to the service-level requirements established in the contract. Contractor negotiators should also specify that the provider and any subcontractors it uses remain liable to fulfill all services in the agreement to the specifications documented in the MSA.

1.9 Conclusion: A Comprehensive MSA Achieves Results

MSAs are largely viewed as legal documents crafted by lawyers while clients managing the deal focus on the SOW and other MSA schedules that define what needs to be done. This is shortsighted, because the MSA sets the overall management structure for the agreement. If an organization does not fully understand the obligations agreed to in the MSA, it will find trying to manage a service provider challenging. This lack of understanding puts client managers at an extreme disadvantage and limits their ability to successfully manage the deal.

Management of an outsourcing deal is highly dependent on the MSA, which describes the processes, escalation paths and rules that both parties in the agreement will follow. Clients must have an appreciation of the overarching T&Cs (the MSA) and the MSA schedules to manage the deal effectively.

RECOMMENDED READING

"A Guide for Building and Understanding Outsourcing Contracts: The 19 Distinct Articles in a Master Service Agreement"

"Outsourcing Contracts: Guidelines for Master Service Agreements and Schedules"

"Best Practices for Understanding and Negotiating Outsourcing Contract Risks"

"Assess Four Factors Before Renegotiating Outsourcing Contracts"

"Toolkit: Use Sourcing Governance to Deal Effectively With Service Misalignment"

Note 1 Schedules/Attachments

Attached to the MSA should be a series of schedules or attachments that define the work to be performed. Please refer to "Outsourcing Contracts: Guidelines for Master Service Agreements and Schedules" for more detailed guidance on the 15 best-practice schedules that are attached to the MSA.

REGIONAL HEADQUARTERS

Corporate Headquarters

56 Top Gallant Road
Stamford, CT 06902-7700
U.S.A.
+1 203 964 0096

European Headquarters

Tamesis
The Glanty
Egham
Surrey, TW20 9AW
UNITED KINGDOM
+44 1784 431611

Asia/Pacific Headquarters

Gartner Australasia Pty. Ltd.
Level 9, 141 Walker Street
North Sydney
New South Wales 2060
AUSTRALIA
+61 2 9459 4600

Japan Headquarters

Gartner Japan Ltd.
Aobadai Hills, 6F
7-7, Aobadai, 4-chome
Meguro-ku, Tokyo 153-0042
JAPAN
+81 3 3481 3670

Latin America Headquarters

Gartner do Brazil
Av. das Nações Unidas, 12551
9º andar—World Trade Center
04578-903—São Paulo SP
BRAZIL
+55 11 3443 1509